PETITION AND TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 26

THE UNITED STATES, PETITIONER

vs.

KIRBY LUMBER COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED FEBRUARY 28, 1931
CERTIORARI GRANTED APRIL 20, 1931
(35681)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 759

THE UNITED STATES, PETITIONER

vs.

KIRBY LUMBER COMPANY

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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1 In the Supreme Court of the United States

October Term, 1930

No. 759

THE UNITED STATES, PETITIONER

v.

KIRBY LUMBER COMPANY

Petition for a Writ of Certiorari to the Court of Claims

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims in the above case rendered December 1, 1930. The opinion of the Court of Claims is reported in 44 F. (2d) 885.

Statutes and Regulations Involved

The revenue act of 1921 (c. 136, 42 Stat. 227, 237, 254) provides:

"SEC. 233. (d) That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 * * *

"SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations,
2 trades, businesses, commerce, *or sales, or dealings in property*, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, *or gains or profits and income derived from any source whatever.* * * *" (Italics ours.)

Articles 50 and 545, Regulations 62, promulgated under the revenue act of 1921, provide:

"ART. 50. Forgiveness of indebtedness.—The cancellation and forgiveness of indebtedness is dependent on the circumstances for its effect. It may amount to a payment of income or to a gift or to a capital transaction. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, however, a creditor merely desires to benefit a debtor, and without any consideration therefor cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income. If a stockholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. * * *

"ART. 545. Sale and retirement of corporate bonds.—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c). If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year."

* * * * * * *

STATEMENT

The Kirby Lumber Company, a Texas corporation, on July 16, 1923, mortgaged its property to secure the payment of certain
3 bonds, $12,126,800 par value of which were issued on that date. (Findings 1, 4.) For these bonds the Lumber Company received cash at par for each bond. (Finding 7.)

During the same year, 1923, the Kirby Lumber Company purchased and retired bonds of this issue aggregating $1,078,300 par value for $940,778.70, or $137,521.30 less than what the company received for the same bonds in the same year. (Finding 5.)

On March 13, 1924, the Kirby Lumber Company filed its income tax return for the calendar year 1923, disclosing a tax liability of $188,062.24. (Finding 2.) Included in this return was $124,446.45 of the sum of $137,521.30. (Finding 6.) Thereafter, on February 16, 1928, the Commissioner of Internal Revenue made an additional assessment against the lumber company for 1923 of $8,047.05. (Finding 3.) In this assessment the commissioner included, as subject to tax, an additional sum of $13,074.85, being the difference between $137,521.30 and $124,446.45. (Finding 6.) There was thus included in the respondent's taxable income for 1923 the entire sum of $137,521.30, representing the difference between the issuing price and the repurchase price of the bonds bought back by the taxpayer in 1923. (Finding 6.)

A claim for refund of $17,188.99 was duly filed on the ground that the sum of $137,521.30 was not taxable gain to the Kirby Lumber Company. (Finding 8.) This claim was rejected, (Finding 9),
4 and thereupon the respondent brought suit in the Court of Claims. That court, basing its decision upon Bowers v. Kerbaugh-Empire Co., 271 U. S. 170, held that the respondent was entitled to recover the sum of $17,188.99.

QUESTION PRESENTED

Whether a corporation which sells its own bonds for par, and during the same year purchases back some of the same bonds for less than par and retires them, thereby realizes a taxable gain under the revenue act of 1921.

SPECIFICATION OF ERRORS

The court below erred:

1. In holding that the gain resulting from the sale and retirement of the respondent's bonds was not taxable as income;

2. In giving judgment for the respondent.

REASONS FOR GRANTING THE WRIT.

1. The court below conceded that the respondent derived a gain from buying back and retiring its bonds at less than the issuing price, but held upon the authority of Bowers *v.* Kerbaugh-Empire Co., 271 U. S. 170, that that gain did not constitute taxable income. We submit that the court below erroneously construed the case cited. In that case the taxpayer, before the war, borrowed money which it agreed to repay in German marks. This money was used in its business and lost. In 1921 the taxpayer repaid the loan, but in the mean time the value of the mark had depreciated greatly. The difference in the value of the marks borrowed at the time of the loan and at the time of the repayment was approximately $700,000. The taxpayer's losses, in the transactions for which the money was borrowed, exceeded that amount. Because the borrowed money had been consumed in the business loss, this court there held that the mere diminution of this loss did not constitute taxable income. The court emphasized the fact that "the result of the whole transaction was a loss," and stated (p. 175):

"The contention that the item in question is cash gain disregards the fact that the borrowed money was lost and that the excess of such loss over income was more than the amount borrowed. When the loans were made and notes given the assets and liabilities of defendant in error were increased alike. The loss of the money borrowed wiped out the increase of assets, but the liability remained. The assets were further diminished by payment of the debt. The loss was less than it would have been if the marks had not declined in value; but the mere diminution of loss is not gain, profit, or income."

We submit that the Kerbaugh-Empire decision is not applicable to the instant case. Here, as a result of the issuance and repurchase of its bonds, the taxpayer made a conceded gain. When the respondent issued its bonds at par its assets and liabilities were increased in equal amounts. When it bought back its bonds at less than par its liabilities were decreased by the face value of the bonds, but its assets were decreased only by what it paid for the bonds. In the instant case there was no loss but on the contrary a clear profit. This gain was represented by actual cash in the respondent's treasury.

That the application of the *Kerbaugh-Empire Company case* to the question here presented was erroneous is clearly indicated by the language of this court in Burnet, Commissioner, *v.* Sanford &

Brooks Company, No. 31, October term, 1930, decided January 5, 1931 (not yet reported), where, referring to the Kerbaugh-Empire Company case, this court said:

"In that case the taxpayer, which had lost in business, borrowed money, which was to be repaid in German marks, and which was later paid in depreciated currency, *had neither made a profit on the transaction nor received any money or property which could have been made subject to the tax.*" (Italics ours.)

In the instant case there is both (1) a clear gain or profit and (2) actual cash received during the year in excess of disbursements made or incurred.

2. The decision of the court below is in conflict with administrative rulings and regulations of long standing and which have acquired legislative sanction by acquiescence. Article 545 of Regulations 62, *supra*, expressly provides that if a corporation purchases and retires bonds issued at par for a price less than par, the excess of the issuing price over the purchase price is income. This regulation was first issued as article 544 of Regulations 45, promulgated under the revenue act of 1918. It has been reissued as article 545 of Regulations 62, promulgated under the 1921 act, as article 545 of Regulations 65, promulgated under the 1924 act, as article 545 of Regulations 69, promulgated under the 1926 act, and as article 68 of Regulations 74, promulgated under the 1928 act. Since the regulations in question permit the corporation to deduct the loss where bonds are issued and then repurchased at a price in excess of the issuing price, it is submitted that they deal with the matter comprehensively and reasonably. Under these circumstances they have the force and effect of law and should not be disturbed except for weighty reasons. Fawcus Machine Company *v.* United States, No. 40, October term, 1930, decided January 5, 1931; National Lead Co. *v.* United States, 252 U. S. 140.

3. The question is one of importance in the administration of the tax laws. A large number of cases raising the precise point here involved are now pending in the Internal Revenue Bureau. A careful review of these cases indicates that the amount of taxes involved approximates $10,000,000. Although the opinion below represents the first court decision on the question presented, the Board of Tax Appeals, upon the authority of the Kerbaugh-Empire case, has decided a number of cases in accordance with the decision in the instant case, the first of these being Independent Brewing Company of Pittsburgh, 4 B. T. A. 870. The Government has not acquiesced in these decisions, and appeals have been taken in Kirby Lumber Company, 9 B. T. A. 1048, and American Tobacco Company, 20 B. T. A. 586, to the Circuit Court of Appeals for the Fifth and Second Circuits, respectively. There are pending in various district courts at least ten cases involving the same question. Until the question is finally determined there will be many suits to recover taxes assessed in accordance with the regulations. It will relieve the dockets of the lower Federal courts of the cases already begun and of those about to be begun if the writ issues.

4. Somewhat analogous questions were presented in Great Northern Ry. Co. v. Lynch, 292 Fed. 903 (D. Minn.) and Commissioner v. Simmons Gin Co., 43 F. (2d) 327 (C. C. A. 10th), which cases are not harmonious with the instant case, but we have found no conflict of decisions upon the question here involved.

CONCLUSION

It is respectfully submitted that this petition should be granted.

THOMAS D. THACHER,
Solicitor General.

Per W. M. S.

FEBRUARY, 1931.

In the Court of Claims

No. L-52

KIRBY LUMBER COMPANY, PLAINTIFF

vs.

THE UNITED STATES, DEFENDANT

I. *Petition*

Filed February 25, 1930

To the honorable the Chief Justice and the Judges of the Court of Claims:

I

The plaintiff, the Kirby Lumber Company, is a corporation organized and existing under the laws of the State of Texas, with its principal office at 911-915 Main Street, Houston, Texas.

II

Within the time prescribed by law the plaintiff duly filed with the collector of internal revenue at Austin, Texas, an income tax return for the calendar year 1923, and paid the tax shown thereon to be due.

III

On July 16, 1923, the Kirby Lumber Company made a deed
10 of trust or mortgage on certain of its property to the Miners Bank of Wilkes-Barre, Wilkes-Barre, Pennsylvania, trustee, to secure the payment of certain bonds aggregating the total prin-

cipal sum of $14,000,000 which were to be issued July 16, 1923. Although the deed of trust or mortgage authorized the issue of $14,000,000 in bonds, only $12,126,800 were actually issued. The article in the deed of trust or mortgage describing the said issue is as follows:

Article I

Concerning the Bonds

Section 1. The bonds to be issued hereunder shall be in denominations of one hundred ($100.00) dollars, five hundred ($500.00) dollars, and one thousand ($1,000.00) dollars, respectively. All bonds issued shall be numbered consecutively from 1 to 15150, both inclusive. Bonds numbers 1 to 1000, both inclusive, shall be of the denomination of one hundred ($100.00) dollars each; bonds numbers 1001 to 1500, both inclusive, shall be of the denomination of five hundred ($500.00) dollars each; bonds numbers 1501 to 15150, both inclusive, shall be of the denomination of one thousand ($1,000.00) dollars each. All bonds are of like tenor, terms and effect; are dated July 16, A. D. 1923, and are due and payable at the First National Bank of Houston, Houston, Texas, on the 16th day of July, A. D. 1938. They bear interest at the rate of six per cent (6%) per annum, interest payable semiannually on the 16th day of January and the 16th day of July, in each year, and coupons for the several installments of interest are attached to the respective bonds, and each bond shall be authenticated by the trustee, and contain a form for the registration thereof, all of which shall be in substantially the following form, to wit:

11 (Form of bond)

United States of America

State of Texas

No. —— $100.00 ($500.00) ($1,000.00) (The correct denomination of each bond will be set at the proper space.)

Kirby Lumber Company First Mortgage Six Per Cent Sinking Fund Gold Bond

Kirby Lumber Company, a corporation created under the laws of the State of Texas, with its domicile in the city of Houston, in Harris County, Texas (hereinafter called company), acknowledges itself to be indebted and, for value received, hereby promises to pay to the bearer hereof (or in case this bond be registered, to the registered owner hereof), the sum of one hundred ($100.00) dollars ($500.00) ($1,000.00) (correct denomination of each bond will be

inserted here) in gold coin of the United States of America, of or equal to the present standard of weight and fineness, on the sixteenth day of July, A. D. 1938, together with interest thereon from the sixteenth day of July, A. D. 1923, at the rate of six per cent per annum, payable in like gold coin, semi-annually, on the sixteenth day of January and the sixteenth day of July in each year, until the principal sum shall be paid, interest payable on presentation and surrender of the interest coupons hereto attached as they severally mature. The principal hereof is payable at the office of the First National Bank of Houston, Houston, Texas, upon presentation and surrender of this bond, when drawn or at its maturity. The interest hereon is payable at the office of the New York Trust Company of New York, in the city of New York, or at the holder's option at the
12 First National Bank of Houston, Houston, Texas, upon presentation and surrender of the respective coupons hereto attached as they severally mature.

This bond is one of a series of fifteen thousand, one hundred and fifty bonds issued by the company, and numbered consecutively from 1 to 15,150, both inclusive, bonds numbered 1 to 1,000, both inclusive, being for the sum of one hundred dollars each, and bonds numbered 1,001 to 1,500, both inclusive, being for the sum of five hundred dollars each, and bonds numbered 1,501 to 15,150, both inclusive, being for the sum of one thousand dollars each; all of like tenor, terms, date, and effect, differing only as to amount, and aggregating the total principal sum, par value, of fourteen million ($14,000,000.00) dollars. All of said bonds are equally secured by a deed of trust or mortgage dated the 16th day of July, A. D. 1923, made by the company to Miners Bank of Wilkes-Barre, Wilkes-Barre, Pennsylvania, as trustee; and for the description of the property thereby mortgaged, the nature and extent of the security and the rights of the holders of the bonds issued thereunder, reference is hereby made to said mortgage or deed of trust, with the same force and effect as if the provisions thereof were herein fully set forth.

The right is hereby reserved to the company to draw, by lot, from time to time, outstanding bonds, on any semi-annual interest date, and to redeem the same by the payment of the principal of such bonds and accrued interest thereon, plus a premium of two per cent on the principal thereof, upon giving thirty (30) days' notice, by publication in some newspaper of general circulation, published in the city of New York, and by depositing in the First National Bank of Houston, Houston, Texas, to be used for that purpose only, the amount necessary to pay the principal, premium and interest in full of each bond so drawn, on or before the advertised date of such payment. The company likewise reserves the right to redeem all bonds at any time outstanding, upon any semi-annual interest date
13 upon like advertisement, by payment therefor at par and accrued interest, plus five per cent on the principal of such bonds.

This bond shall not be valid or obligatory for any purpose unless and until authenticated as one of the series of bonds herein described

by a certificate endorsed hereon and executed by the trustee, or its successor in trust.

This bond shall pass by delivery, and be payable to the bearer hereof, unless registered in the owner's name on the registration books kept at the office of the New York Trust Company of New York, as registrar, in the city of New York. Such registration shall be noted on the bond by said registrar, after which no transfer hereof shall be valid unless made on the books of the registrar by the registered owner hereof, in person or by his attorney duly authorized, and similarly noted on the bond. This bond, however, may be discharged from registration by being transferred in the manner aforesaid to the bearer, by notation hereon by the registrar, after which it shall be transferable by delivery; but may again be registered or discharged from registration as before, and as often as the owner may desire. The interest coupons hereon, however, shall continue negotiable and transferable by delivery, and payable to bearer, notwithstanding any registration hereof.

In witness whereof, Kirby Lumber Company has caused these presents to be signed in its corporate name, by its president, its corporate seal to be hereto affixed, to be attested by its secretary, and the interest coupons hereto attached to be authenticated by the facsimile signature of its treasurer, as of the sixteenth day of July, A. D. 1923.

KIRBY LUMBER COMPANY,
By _____
President.

Attest:

_____
Secretary.

14 (Form of interest coupon)

No. _____ $3.00 ($15.00) ($30.00)
(Correct amount will be inserted in each coupon)

On the sixteenth day of January, A. D. 1924 (correct date of payment will be inserted in each coupon), Kirby Lumber Company will pay to the bearer hereof, at the office of the New York Trust Company of New York, in the city of New York, or, at the option of the holder hereof, at the First National Bank of Houston, in the city of Houston, Texas, three ($3.00), (fifteen) ($15.00), (thirty) ($30.00) (correct amount will be set out in each coupon), dollars in gold coin, being six months' interest then due on its first mortgage six per cent sinking fund gold bond No. ——.

_____
Treasurer.

15 (Form of trustee's certificate

Trustee's Certificate

Office of
Miners Bank of Wilkes-Barre,
Wilkes-Barre, Pennsylvania.

This is to certify that this bond is one of the series of 15,150 bonds, numbered from 1 to 15,150, both inclusive, mentioned in the trust deed or mortgage referred to in this bond.

MINERS BANK OF WILKES-BARRE,
Wilkes-Barre, Pa.,
Trustee,

By ----------
Vice President.

(Form of registration)

(No writing hereon except by the New York Trust Company of New York, registrar, or by its successor)

Date of registration	In whose name registered	Registrar
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----------	----------	----------
----------	----------	----------

16 IV

The bonds mentioned in Paragraph III above were dated July 16, 1923, and were issued at par.

V

During the year 1923 the Kirby Lumber Company purchased certain of these bonds at less than par, which was also the issue price, and retired them. The amount of the bonds so retired, and the amount paid for them by the Kirby Lumber Company, are as follows:

Par value (issue price)	Paid for bonds	Difference
$1,078,300.00	$940,788.07	$137,511.93

VI

On or about January 24, 1928, the plaintiff filed with the Collector of Internal Revenue at Austin, Texas, a claim for the refund of $17,188.99, or such greater amount as is legally refundable. The said claim for refund was based on the ground that the difference between the issue price of the bonds retired and the price the plaintiff paid therefor is not taxable gain to the plaintiff.

VII

On May 8, 1928, the Deputy Commissioner of Internal Revenue wrote the plaintiff that "The claim will, therefore, be rejected. The rejection of the claim will officially appear on the next schedule to be approved by the Commissioner."

17

VIII

By reason of the action of the Commissioner of Internal Revenue in refusing to refund to the plaintiff the sum of seventeen thousand one hundred eighty-eight dollars and ninety-nine cents ($17,188.99), together with interest from the date of payment, the whole of the said amount plus interest is now wrongfully and unlawfully withheld from the plaintiff without its consent and against its will by the United States.

IX

No other action has been had on said claim in Congress or by any of the departments; no other person than the plaintiff is the owner thereof or interested therein; no assignment or transfer of this claim, or any part thereof or interest therein, has been made; plaintiff is justly entitled to the amount herein claimed from the United States after allowing all just credits and offsets. The plaintiff has at all times borne true faith and allegiance to the Government of the United States, and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against the said Government.

Wherefore the plaintiff asks judgment against the United States in the sum of seventeen thousand one hundred eighty-eight dollars and ninety-nine cents ($17,188.99) plus interest thereon from the date of payment.

KIRBY LUMBER COMPANY,
By ROBERT ASH,
THOMAS J. REILLY,
Attorneys for Plaintiff,
Munsey Building, Washington, D. C.

18 [*Duly sworn to by C. H. Rhoads; jurat omitted in printing.*]

19 II. *General traverse*

Filed April 5, 1930.

And now comes the Attorney General, on behalf of the United States, and answering the petition of the plaintiff herein denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

CHARLES B. RUGG,
Assistant Attorney General.

III. *Argument and submission of case*

On October 16, 1930, this case was argued and submitted on merits by Mr. Thomas J. Reilly, for the plaintiff, and by Mr. Assistant Attorney General Charles B. Rugg, for defendant.

20 IV. *Special findings of fact, conclusion of law and opinion of the court by Williams, J.*

Filed December 1, 1930

Mr. Thomas J. Reilly for plaintiff. *Mr. Robert Ash* was on the brief.

Mr. Assistant Attorney General Charles B. Rugg for defendant. *Messrs. Fred K. Dyer* and *William E. Davis* were on the brief.

The plaintiff in this case during the taxable year 1923, issued its own bonds at par and subsequently within the year, purchased and retired certain of the said bonds, so issued, at a price less than the issuing price.

The excess of the issuing price over the purchase price of the said bonds was the sum of $137,521.30.

The issue in the case is whether or not this item, $137,521.30, was taxable as income to the plaintiff for the year in question.

This case having been heard by the Court of Claims upon a stipulation of facts, signed on behalf of plaintiff by its attorney, Mr. Robert Ash, and on behalf of the defendant by Assistant Attorney General Charles B. Rugg, and the evidence, the court makes the following

Special findings of fact

1. The plaintiff, the Kirby Lumber Company, is a corporation organized and existing under the laws of the State of Texas, with its principal office at 911–915 Main Street, Houston, Texas.

2. The plaintiff on or about March 13, 1924, filed with the collector of internal revenue at Austin, Texas, its income-tax return for the calendar year 1923 disclosing a tax liability of $188,062.24, which was duly paid.

3. On February 16, 1928, the Commissioner of Internal Revenue made an additional assessment in the sum of $8,047.05 for the year 1923, which was duly paid.

4. On July 16, 1923, the Kirby Lumber Company made a deed of trust or mortgage of certain of its property to secure the payment of certain bonds, aggregating the total principal sum of $14,000,000. Although the deed of trust authorized the issue of $14,000,000 in bonds, only $12,126,800 were actually issued and they were issued at par on July 16, 1923.

5. During the year 1923, the Kirby Lumber Company purchased $1,078,300 par value of these bonds for $940,778.70, or $137,521.30 less than the issuing price, and retired the said bonds so purchased.

6. In its return referred to in Finding 2, the taxpayer included $124,446.45 of the $137,521.30, referred to in Finding 5, as a
21 portion of its income for the year 1923, and in the said additional assessment for the year 1923 the commissioner included as an additional amount of income, subject to tax for said year, an additional sum in the amount of $13,074.85 on account of the purchase of bonds at less than the issuing price; so that there was included in plaintiff's taxable income for the year 1923 the said sum of $137,521.30 referred to in Finding 5.

7. The bonds mentioned in Finding 4 above were issued at par, the Kirby Lumber Company receiving the par value of the bonds issued, without incurring expense incident to the issue of the said bonds.

8. On or about January 24, 1928, the plaintiff filed with the collector of internal revenue at Austin, Texas, a claim for refund of $17,188.99, or such greater amount as is legally refundable. The said claim for refund was based on the ground that the difference between the issuing price of the bonds retired and the price at which they were subsequently acquired by the plaintiff was not taxable gain to the plaintiff.

9. On May 8, 1928, the Deputy Commissioner of Internal Revenue wrote the plaintiff that, "The claim will, therefore, be rejected. The rejection of the claim will officially appear on the next schedule to be approved by the commissioner."

Conclusion of law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover the sum of $17,188.99.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States the sum of seventeen thousand one hun-

dred eighty-eight dollars and ninety-nine cents ($17,188.99), with interest at the rate of six per cent per annum from the dates of payments thereof to such date as the Commissioner of Internal Revenue may determine, in accordance with the provisions of subsection (b), section 177 of the Judicial Code, being a part of the revenue act of May, 1928.

Opinion

WILLIAMS, Judge, delivered the opinion of the court:

The plaintiff brings this suit to recover $17,188.99, income taxes which it claims were erroneously assessed against it for the calendar year 1923.

The plaintiff during the taxable year issued its own bonds at par, and later within the year purchased on the open market certain of these bonds at less than par, and retired them. The difference between the par value of such bonds and the price at which they were purchased and retired was the sum of $137,521.30.

The question before the court for determination is this, namely, is the $137,521.30 the excess of the issuing price of the bonds over the purchase price a taxable gain or income to the plaintiff for the year 1923.

Article 545 of Treasury Regulations 62 provides:

"Sale and retirement of corporate bonds.—(1) (a) If bonds are issued by a corporation at their face value, the corporation
22 realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year."

In conformity with the regulations the Commissioner of Internal Revenue determined that the excess of the issuing price of the bonds over the purchase price represented taxable income to the plaintiff and assessed and collected the taxes in question.

The plaintiff contends that the item in controversy is not taxable as income because it was not gain derived from either capital or labor, or from both combined, or through a sale or conversion of capital, and cites in support of its contention a long line of decisions of the Board of Tax Appeals, which decisions are premised on Bowers *v.* Kerbaugh-Empire Co., 271 U. S. 170–174.

In the Kerbaugh-Empire case, supra, the defendant in error had before the World War borrowed money from a bank in Germany, repayable in marks or their equivalent in gold coin of the United States.

A subsidiary of the defendant in error, for whose use the money was borrowed, lost the money in business and claimed, and was allowed, a loss of such amounts in its income-tax returns for the years in which the losses occurred.

In 1921 the defendant in error made payment of the balance due on its notes. Owing to the depreciated value, at that time, of the German mark there was, measured by United States gold coin, a difference between the value of the marks borrowed at the time the loans were made and the amount paid in liquidation of the unpaid balance the sum of $684,456.18.

The Commissioner of Internal Revenue treated this sum of $684,456.18 as income for the year 1921 and assessed taxes thereon. The Supreme Court held that it was not taxable as income. The court stated the issue to be:

"The question for decision is whether the difference between the value of marks measured by dollars at the time of payment to the custodian and the value when the loans were made was income."

The court then said:

"The sixteenth amendment declares that Congress shall have power to levy and collect taxes on income, 'from whatever source derived,' without apportionment among the several States and without regard to any census or enumeration.

* * * * * * *

"* * * 'Income' has been taken to mean the same thing as used in the corporation excise tax act of 1909, in the sixteenth amendment and in the various revenue acts subsequently passed. Southern Pacific Co. *v.* Lowe, 247 U. S. 330, 335; Merchants L. & T. Co. *v.* Smietanka, 255 U. S. 509, 519. After full consideration, this court declared that income may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital. Stratton's Independence *v.* Howbert, 231 U. S. 399, 415; Doyle *v.* Mitchell Brothers Co., 247 U. S. 179, 185; Eisner *v.* Macomber, 252 U. S. 189, 207. And that definition has been adhered to and applied repeatedly. See e. g. Merchant L. & T. Co. *v.* Smietanka, supra, 518; Goodrich *v.* Edwards, 255 U. S. 527, 535; United States *v.* Phellis, 257 U. S. 156, 169; Miles *v.* Safe Deposit Co., 259 U. S. 247, 252–253; United States *v.* Supplee-Biddle Co., 265 U. S. 189, 194; Irwin *v.* Gavit, 268 U. S. 161, 167; Edwards *v.* Cuba Railroad, 268 U. S. 628, 633. In determining what constitutes income substance rather than form is to be given controlling weight. Eisner *v.* Macomber, supra, 206."

23

Counsel for the Government contend that the decision in this case does not support the position of the plaintiff in the instant case. It is urged that the decision is "authority for the proposition that when A borrows money and loses, through business reverses, the entire amount of money borrowed, any subsequent settlement with the lender whereby A is enabled to liquidate his obligation for

less than its face amount, the difference between the amount paid to liquidate the obligation and the face amount of the obligation is not income."

Counsel say:

"It is conceivable that had the Kirby Lumber Company been insolvent when it purchased the bonds in question at a discount on the issuing price, the decision of the Supreme Court in the Kerbaugh-Empire Company case might be authority to sustain its position that the transaction resulted in no taxable gain; but, so far as the record in this case discloses, such were not the facts."

We can not agree with the contentions of counsel for the defendant. It is obvious that where a person issues obligations and afterwards redeems such obligations at a price less than that of their issue, such person derives gain through the transaction. The question is whether such gain is taxable as income. In our opinion the question whether the person engaging in such transaction is solvent or insolvent, or whether he made a profit or suffered a loss through the use of the money for which the obligations were issued is wholly immaterial.

That this was the view of the Supreme Court in the Kerbaugh-Empire case is unmistakably shown in the court's precise and explicit statement of the issue. Had the factors urged by the defendant been considered material to the determination of the case they would undoubtedly have been included by the court in its statement of the issue.

We think the decision in the Kerbaugh-Empire case fully sustains the contentions of plaintiff in the instant case that the excess of the issuing price of its bonds over the purchasing price of such of its bonds as it purchased subsequent to issue, is not taxable as income, and that the taxes herein were erroneously assessed and collected.

Judgment is therefore awarded the plaintiff in the sum of $17,188.99, with interest thereon as is by law provided. It is so ordered.

WHALEY, Judge; LITTLETON, Judge; GREEN, Judge; and BOOTH, Chief Justice, concur.

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V. *Judgment*

At a Court of Claims held in the city of Washington on the 1st day of December, A. D., 1930, judgment was ordered to be entered as follows:

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover the sum of $17,188.99.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States the sum of seventeen thousand one hundred eighty-eight dollars and ninety-nine cents ($17,188.99), with interest at the rate of six per cent per annum from the dates of pay-

ments thereof to such date as the Commissioner of Internal Revenue may determine, in accordance with the provisions of subsection (b), section 177 of the Judicial Code, being a part of the revenue act of May, 1928.

25 [Clerk's Certificate to foregoing transcript omitted in printing.]

[Indorsement on cover:] File No. 35,681. Court of Claims. Term No. 759. The United States, petitioner *v.* Kirby Lumber Company. Petition for a writ of certiorari and exhibit thereto. Filed February 28, 1931. File No. 35,681.

U. S. GOVERNMENT PRINTING OFFICE: 1931

Supreme Court of the United States

Order allowing certiorari

Filed April 20, 1931

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1931